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SUBJECT: ARMENIA'S AMBITIOUS 2008 STATE BUDGET

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SUMMARY

¶1. (SBU) On November 28, 2007, the National Assembly of Armenia approved Armenia's 2008 State Budget, which President Kocharian signed on December 4. The 2008 State Budget program is quite ambitious as it predicts a 25.8 percent growth in revenues and a 28.5 percent rise in expenditures over the 2007 Budget. The IMF is concerned that an expansion at this rate will put more of a burden on monetary policy to control inflation. The main feature of the 2008 Budget is the almost 65 percent increase in average pensions, a move which may feature in Prime Minister Serzh Sargsian's presidential's campaign. END SUMMARY.

BUDGET REVENUES AND EXPENDITURES

¶2. (U) The 2008 State Budget calls for 746 billion Armenian drams (AMD) in revenues (approximately USD 2.5 billion based on the current rate of 304 AMD per USD) and 822.05 billion AMD (approximately USD 2.7 billion) in expenditures, which constitute 21.2 percent and 23.4 percent of the projected annual GDP respectively. The budget deficit -- targeted at 2.16 percent of GDP -- is expected to amount to AMD 76.05 billion (USD 250 million). Under the 2008 Budget, the GOAM plans to spend 45.9 percent of total expenditures on Social and Cultural programs, 21.7 percent in the Defense, National Security, Public Order and Judicial Sectors and 15.1 percent on the Economy.

MACRO-ECONOMIC PROJECTIONS

¶3. (U) The 2008 Budget is based on a projected nominal GDP of AMD 3,520 billion (USD 11.6 billion) with a GDP growth rate projected at 10 percent. During the draft Budget discussions, the exchange rate for 2008 was projected at AMD 325.1 per one USD, though currently one USD trades at about 304 AMD. The IMF has raised concerns that the more expansionary 2008 Budget may reinforce real appreciation pressures on the Armenian dram and place an additional burden on monetary policy to safeguard price stability.

TAX REVENUES TO GROW CONSIDERABLY

¶4. (U) According to the 2008 Budget, Tax Revenues and State Duties are expected to account for some 80 percent of total revenues,

mandatory social security payments 14.1 percent, official grants 4.7 percent and other revenues 1.2 percent. Tax revenues and state duties are projected to amount AMD 597.13 billion (USD 1.96 billion); the taxes and duties to GDP ratio is thus predicted at 17 percent, a significant improvement over the 15.7 percent projection for 2007, and actual 14.4 percent for 2006.

LARGE INCREASE IN PENSIONS

15. (U) Expenditures for Social Protection, programmed to be 6.2 percent of GDP, are expected to reach AMD 219.22 billion (USD 721.1 million), AMD 71 billion or 48 percent over 2007 Budget allocations. According to the new Budget, average pensions in 2008 will account for AMD 21,842 (approximately USD 72) per month, almost double the 2007 level. According to IMF calculations, budgetary transfers for the pension increase will increase by 0.9 percent of GDP. In the context of the planned pension increase, the GOAM will consolidate the State Fund for Social Insurance with the State Budget in 2008.

HEALTH AND EDUCATION EXPENDITURES

16. (U) Health and education allocations are slated to remain broadly stable in terms of GDP. The GOAM will apportion AMD 54.48 billion (USD 179.2 million) or 1.5 percent of the projected GDP to the healthcare sector, which exceeds the 2007 Budget allocations by AMD 10.4 billion or 23.6 percent. This will allow salaries in the healthcare system to increase on average 10-20 percent. Education expenditures are expected to reach AMD 103.68 billion (USD 341 million) or about 2.9 percent of projected GDP, up by 20.4 percent from 2007.

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DEFENSE BUDGET

17. (U) Compared with 2007, the GOAM has increased the Defense budget by approximately 25 percent to AMD 125.44 billion (USD 412.6 million), equivalent to 3.6 percent of projected GDP or 15.3 percent of total expenditures. This will allow around a 10 percent increase in military pay. The budget also envisages considerable increases in civil servant, diplomatic and prosecutor's service employees' wages.

BUDGET DEFICIT FINANCING AND PUBLIC DEBT

18. (U) Deficit financing from domestic sources in 2008 is expected to account for 61.2 percent of the total deficit, with the remaining 38.8 percent from external sources. The budget deficit will be partly financed by the issuance of AMD 25 billion (USD 82 million) in treasury bills. Deficit financing from external sources is expected to be equal to AMD 29.5 billion (USD 97 million), and will be mainly comprised of loans from international organizations and foreign governments. According to preliminary estimates, Armenia's Public Debt by the end of 2008 is expected to be equal to USD 1.8 billion or 16.7 percent of GDP, compared with USD 1.6 billion or 18.1 percent of GDP that was expected by year end 2007. External Public Debt is expected to equal USD 1.52 billion by the end of 2008, comprising 84.3 percent -- 14.1 percent of GDP -- of total Public Debt.

COMMENT

19. (SBU) With a highly ambitious 2008 budget that envisions a considerable revenue increase, and with the lack of a coherent and transparent tax system, there is the real likelihood that GOAM tax authorities will step up arbitrary pressure on selected businesses

in order to meet its revenue target. The promised pension increase prior to February's presidential election is almost certainly politically motivated, though admittedly the previous average pension level (roughly USD 35 per month) provided Armenia's elderly with a very meager standard of living. END COMMENT.

PENNINGTON